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U.S. Department of Transportation
Office of the Secretary of Transportation

GENERAL COUNSEL

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Washington, D.C. 20590

December 18, 2000

Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Ex Parte No. 582 (Sub-No. 1)

Dear Secretary Williams:

Enclosed herewith are the original and twenty-five copies of the Reply Comments of the United States Department of Transportation in the above-referenced proceeding. There is also a computer diskette of this document, convertible into Word Perfect. I have included as well an additional copy of the Department's comments that I request be date-stamped and returned with the messenger.

Respectfully submitted,

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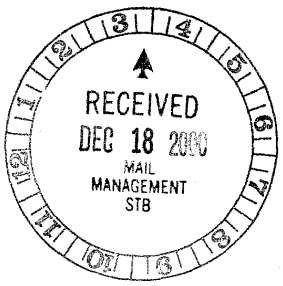
Office of the Secretary
DEC 18 2000
Part of
Public Record

Paul Samuel Smith
Senior Trial Attorney

Enclosures

cc: Parties of Record

Before the
Surface Transportation Board
Washington, D.C.



ORIGINAL

Major Rail Consolidation Procedures	)	Ex Parte No. 582 (Sub-No. 1)

Reply Comments of the
United States Department of Transportation

I. INTRODUCTION

The U. S. Department of Transportation ("DOT" or "Department") has carefully reviewed the initial filings made in response to the Surface Transportation Board's ("STB" or "Board") Notice of Proposed Rulemaking, served October 3, 2000 ("NPRM"). Nothing in those comments causes us to alter our basic philosophy with respect to this issue, or to change our recommendations with respect to the NPRM. As Secretary Slater remarked in his March 7, 2000 statement before the STB, when he praised the Board for embarking on such a visionary course, the new guidelines must "enable the U.S. to maintain a rail system that is safe, competitive and profitably able to meet the needs of customers and communities working together with, and not at the expense of, its employees." Statement at 1.

The rail transportation system of the 21st century, and the transportation system as a whole, must be "international in reach, intermodal in form, intelligent in character and inclusive in service." Id., at 2. The proposals and comments we have offered in various phases of this proceeding have been "designed to raise the evidentiary threshold for future mergers in an industry that is already highly concentrated, where transactions are likely to pose significant risks and offer relatively few public benefits." DOT Comments filed May 16, 2000 ("ANPRM Comments") at 2. We have not recommended that any future consolidations be summarily rejected, but only that those resulting in a financially viable, more responsive rail industry be approved. "A healthy, competitive railroad industry is vital to our national transportation system and to our economy as a whole. The Board must work actively to help achieve and maintain that goal, approving mergers that would foster that result and rejecting those that would not." Id.

Many of the initial comments filed in response to the NPRM mirror these goals. We note a strong degree of consensus on the proposals offered by the Board; on the majority of issues, participants seem to differ with respect to some

of the details, but not with respect to the central objective of the provision. Disagreement remains on significant issues, however. DOT offers its views on selected issues below.

II. DISCUSSION

A. Labor Issues

Cram Down

In prior comments, the Department stated that whatever rationale may have existed twenty years ago to permit merged carriers to circumvent the Railway Labor Act, that rationale no longer exists today with two major carriers in the West and two in the East. ANPRM Comments at 24. DOT also offered a proposal to end the most egregious forms of wholesale contract overrides, while retaining for the merged carriers the ability to override contract provisions that were a genuine obstacle to the implementation of a merger transaction.

In the NPRM, the Board proposed a rule change that was consistent with the spirit and the goal of the Department's proposal. The STB stated that in the future it would "look with extreme disfavor on overrides of collective bargaining agreements except to the very limited extent necessary to carry out an approved transaction." NPRM at 17. The Department in its comments on the NPRM commended the Board for the proposed rule change on cram down.

However, the Department also cautioned that the NPRM "lacked guidance or elaboration" regarding the proposed change on cram down and, as a consequence, there was the danger that any "misinterpretation or ambiguity" would perpetuate the disagreement over cram down. DOT Initial Comments at 15-16. The disparate views of the labor organizations and the carriers (commenting through their national bargaining committee) make clear that the final rule must articulate a concrete and unambiguous new standard on cram down.

The carriers' National Railway Labor Conference ("NRLC"), for example, takes the position that the Board overreached in the NPRM and that it lacks the authority to modify cram down or even to change current Board policy. NRLC Comments at 1. The labor organizations, on the other hand, take the position that the Board in the NPRM "has not offered concrete language and specific rules that would bring about real change." Allied Rail Unions ("ARU") Comments at 1. Similarly, the Rail Labor Division of the Transportation Trades Department ("Rail Labor Division") states that while it appreciates the Board's identification of cram down as a current and potent source of friction, "[u]nfortunately, ...it effects no real change in the status quo." Rail Labor Division Comments at 8. Now that the Board has abandoned the former paradigm that gave little or no deference to collective bargaining agreements in the march to enhance the operating efficiency of the major railroads, the Department reiterates its recommendation that the Board provide a standard of "necessity" -- the

predicate for cram down -- that distinguishes between contracts that are merely a burden to a transaction and contracts that are an obstacle to a transaction. The City of Palestine case provides a relevant guide that is directly on target for determining when the use of cram down is arguably "necessary." City of Palestine v. United States, 559 F.2nd 408, 414-15 (5th Cir. 1977).

As the Allied Rail Unions state, "[t]he fact that two railroads will meet in Chicago or Kansas City can not possibly necessitate overriding the collective bargaining agreements covering ten of thousands of employees on the east and west coasts." ARU Comments at 4. The ARU goes on to point out that integrating operations at a connecting or common point could not possibly require having seniority districts stretching from Pennsylvania to Colorado, or placing shops in Kentucky under agreements applicable to California. Id.

The hypothetical examples offered by the ARU are a logical and predictable extension of what would happen under the Board's current regulations and policies in a transcontinental merger. As the court stated in City of Palestine, the exemption from all other law should not be a hunting license. Under a standard of necessity that distinguishes between contracts that are merely a burden to a transaction and contracts that are an obstacle to a transaction, employees in the east could not be forced under a contract applicable in the west by administrative fiat, simply because approval was granted for a transcontinental merger. However, where there were conflicting or overlapping contracts at connecting or common points that could be shown to be an obstacle to the transaction, the carriers would be able to make appropriate, but limited, use of the override authority.

In summary, the Department believes that the relative size and bargaining power of the major carriers is more than sufficient to allow normal contract negotiations under the Railway Labor Act to resolve any and all labor issues related to a merger transaction. The consolidation of the rail industry into four major carriers, in itself, justifies ending the license that the carriers have had since 1983 to use the cover of mergers to achieve one-sided contract changes through administrative fiat.

However, barring a complete end to cram down, the Board must follow up on the principle that it enunciated in the NPRM, namely that it "respects the sanctity of collective bargaining agreements and will look with extreme disfavor on overrides ..." NPRM at 17. As the Rail Labor Division recommends, "if the Board intends to fix the problems, it must speak more specifically, more clearly and more directly..." Rail Labor Division Comments at 1. The Department suggests that the appropriate standard for determining when an override is necessary is the standard found in the City of Palestine case.

Other Labor Issues

The United Transportation Union ("UTU") believes that rail labor should have a voice on the service councils proposed in the NPRM to address service issues related merger implementation. UTU Comments at 2. The Department

agrees with the recommendation by the UTU that rail labor should be specifically mentioned in this provision.

The Department also continues to support the expressed previously regarding implementing agreements, relocation of employees, access to test period earnings and cross-border job changes. See DOT Initial Comments at 13-14.

B. Competition

Maintaining open gateways was an important competitive issue addressed by parties in initial comments to the NPRM as well as earlier comments to the ANPRM. Shippers continue to urge that gateways and routings should remain open, but also encourage the Board to clarify the rule by: (1) defining what constitutes "major" gateways and routes, and (2) providing that gateways remain open both physically and economically. Comments of the Edison Electric Institute ("EEI") at 9; American Chemical Council/American Plastics Council at 2-4; National Industrial Transportation League ("NITL") at 18-20. DOT agrees with these comments. In each of our previous filings, we maintained that major routes and gateways should be kept open physically and economically. The Department also encouraged the Board to require all carriers serving affected gateways, not just the merging railroads, to be included in the rule. As we noted earlier, "such a condition would preserve, and perhaps enhance, effective gateway competition" without placing merging carriers at a competitive disadvantage compared to other competing carriers serving the gateway. DOT Initial Comments at 5.

DOT emphasizes, however, that only major gateways and routes should be included under this requirement. We agree with railroad comments that merged carriers should be allowed to close other interchanges and routings if these closings contribute significantly to economies of density and other efficiencies. Comments of CSX Transportation Co. ("CSX") at 17; Union Pacific Railroad Co. ("UP") ANPRM Reply Comments at 36; Norfolk Southern Railway Co. ANPRM Reply Comments at 36.

With respect to "bottleneck routings," the Department continues to urge the Board to streamline the process "to allow captive shippers with contracts from non-applicant carriers to obtain an immediate rate from applicants for their segment of the bottleneck" without first having to succeed in an "access" proceeding. DOT Initial Comments at 6. Finally, while changes to the merger rules might provide bottleneck relief for shippers affected by the transaction, those shippers that are not a part of the transaction would not benefit. As we stated earlier, the issue of bottleneck access should be the subject of an industry wide rulemaking. Id.

A number of shippers have commended the Board for including in the merger rules requirements for applicants to submit proposals for enhancements of competition. However, as several parties note, it is unclear whether proposals

from applicants showing enhanced intermodal competition would meet this requirement, or if the Board intends that this mandate apply solely to enhancements of intramodal (rail-rail) competition. Comments of NITL at 10-11; National Grain and Feed Association ("NGFA") at 4; Committee to Improve American Coal Transportation ("IMPACT") at 10-11. The discussion in the NPRM appeared to DOT to clearly imply that the Board was concerned with intramodal enhancements. But we believe that the shippers have raised a valid point that requires Board clarification.

We do not mean to suggest that applicants should be discouraged from offering intermodal enhancements to competition - only that we believe the Board is, correctly, focusing on rail-rail competition in this proceeding. Any intermodal competitive enhancements should be considered additions to, and not substitutes for, intramodal competitive enhancements.

There is another instance in which the language of the proposed rules has prompted requests for clarification. The STB has indicated its willingness to use its conditioning power to preserve and enhance competition "where both carriers are financially sound," which suggests a reluctance to do so where one or both applicants are financially unsound. Proposed § 1180.1(c); NPRM at 12. Shippers in particular have questioned this provision and the standards to be employed in measuring applicants' financial health; they oppose use of the Board's revenue adequacy standard. See Comments of NITL at 13-14; Dow Chemical Co. at 5-6. The Department considers that the financial instability of merger applicants is a significant factor for a number of basic reasons, including their inability to carry out prospective competitive conditions. We agree that the Board may want to consider imposing less stringent standards in a consolidation involving financially unsound applicants, and that the STB should consider poor financial condition as part of its balancing process to protect the public interest. We certainly share concerns that a carrier's revenue adequacy is not a particularly useful measure for these purposes. We therefore urge the Board to explain how it will determine an applicant's financial weakness in merger proceedings.

C. Service Issues

Service Plans

There appears to be wide support for the service assurance plans that the Board proposes requiring applicants to submit as part of their merger application and operating plan. The Department generally supports the proposed requirement of utilizing planning documents under proposed section 1180.10. However, we wish to reiterate a point that we made previously: the service assurance plans should include benchmark measures of service levels that reflect the customers' perspective, as well as benchmarks that measure the railroads' operating performance. DOT Initial Comments at 12. Adopting a proposal such as that recommended by NITL, which offered specific language for inclusion of transit and cycle times, would accomplish this. NITL Comments at 26.

The railroads have expressed a concern that the service assurance plans should not be viewed as static documents that impute an unreasonable ability on the railroads to forecast economic and business conditions several years after the preparation of the application. Association of American Railroads Comments at 20-21. CSX, for example, points out that the price of crude oil unexpectedly rose from around $8 a barrel to $35 a barrel in about six months. CSX Comments at 52.

The Department does not view the uncertainty of future business conditions as a major issue relative to the service assurance plans. Service plans are intended to ensure that service does not deteriorate after a merger. These plans, aimed at maintaining existing service levels, should not be contingent on a static business environment. The burden should be on the applicants to develop service plans that are sufficiently robust to accommodate normal changes in the business cycle without permitting service levels to fall below pre-merger standards.

Service Guarantees

In contrast to the consensus on service assurance plans, there remains significant disagreement regarding service guarantees and the issue of redress for railroad customers in the event that promised service levels are not met due to post-merger integration problems. Many of the railroads' customers insist on service guarantees that include provisions for timely remedial actions and/or compensation in the event of implementation problems. See, for example, the Comments of NITL, EEI, NGFA; National Mining Association and IMPACT.

Several coal shippers who commented collectively recommended that the Board require as part of any service assurance plan a monetary damage remedy. Joint Comments of Subscribing Coal Shippers at 21. The Subscribing Coal Shippers also asserted that the DOT proposal for negotiated service guarantees, including remedies, is flawed because DOT "assumes the merging carriers will voluntarily enter into such contract arrangements, a result that is most unlikely ... ." Id.

The Department concurs that the applicants would have to have an incentive to offer such guarantees, and we recognize that service guarantees present a "difficult challenge." DOT Reply Comments filed June 5, 2000 at 3. In DOT's view "the STB should take into account any reluctance by applicants to offer service commitments and meaningful dispute resolution systems when it evaluates the benefits and risks of a merger." Id. As we previously noted, both "applicants and shippers...should be strongly encouraged" to enter into contractual agreements. DOT Comments filed May 16, 2000 at 9. However, "[t]he Department opposes direct regulation of service levels by the Board." DOT Reply Comments filed June 5, 2000 at 3.

The Department reiterates that the Board should encourage privately negotiated service guarantees with appropriate remedies to be arranged between the parties to the guarantee. There is also the need for an alternative dispute

resolution process along the lines of the voluntary arbitration procedure recommended by the Railroad-Shipper Transportation Advisory Council and adopted by the Board in Part 1108. See DOT Initial Comments at 10-11.

Passenger Service Benchmarks

Amtrak in its filing recommended that rail passenger operations be treated analogously to freight operations "with respect to benchmarking and quantitatively measuring performance." National Railroad Passenger Corp. Comments at 6. The Department fully agrees that without pre-merger measures of on-time performance and other passenger service indicia, it would be difficult or impossible for the Board or passenger railroads to hold merger carriers responsible for commitments that are made regarding post-merger passenger service levels. As Amtrak moves toward non-subsidized operations in 2003, it and the traveling public deserve the guarantee that passenger services will not be disrupted by merger-related problems, as they have been at times in the past.

D. Environmental Issues

The Burlington Northern and Santa Fe Railway Company ("BNSF") advocated revising the merger rules so as to shorten the overall time between application and final decision. BNSF Comments at 17. BNSF contends that reducing the period for considering a merger would produce a number of economic benefits, because it would reduce uncertainty and allow the purported benefits from the transaction to be obtained sooner. Id., Verified Statement of Robert Krebs at 3-4.

DOT agrees that, in limited circumstances, an expedited procedure could have certain benefits, so long as the shorter schedule did not adversely affect the decision ultimately reached. Particularly in cases where the merger under consideration does not involve two of the larger Class I railroads, the Board may wish to consider a request to compress the proceeding's schedule. See *infra*, at 9. Nevertheless, the Board should be especially careful that any expedited time frame does not give short shrift to a full exploration of the major issues.

Of particular concern is that a shortened schedule could significantly limit the opportunity for communities affected by a transaction to participate fully in the environmental review. In its earlier filings, the Department supported revising the merger rules to ensure that communities potentially subject to environmental impacts from a transaction would be better able to have their problems addressed. We believe that the issue of providing adequate opportunity for communities to participate fully needs to be specifically addressed in any proposal to shorten the timeline, and invites BNSF and others who support this proposal to suggest how this might be accomplished.

Applicants wishing to shorten the schedule could be required to make an affirmative effort to assure that affected communities are given adequate notice of the impacts resulting from the proposed transaction, as well as their options

under the various environmental standards. This would include a requirement to notify all communities of changed impacts that may result from agreements with other communities during the course of the environmental review.

Under the current standards, applicants are required to submit their operating plans and the results of their initial environmental review at the time of filing. If the STB decides to shorten the timetable, it must ensure that affected communities have ample notice of these documents, and how they apply to their community, in advance of the filing of the formal merger application. This would better enable those communities to participate in the scoping process. Additionally, many of these communities have limited resources with which to participate in the process. The Board may wish to consider requiring applicants to provide assistance to such communities, to assure they can effectively protect their interests. For example, applicants could be required to fund consultants, to be directed by the STB, that offer assistance to these communities. Another approach might be to require the applicants to brief each community on the transaction, with an STB representative (or consultant) present.

BNSF's proposed schedule would have the STB issue a notice of intent to prepare an EIS and request comments on the scope of the EIS just seven days after the filing of the application, and issue the final notice on the scope of an EIS forty-five days after the filing of the application. BNSF Comments at 21-22. This may be adequate in those cases where parties are aware of the proposed project beforehand. However, many small communities could well be unaware of the impacts of a proposed transaction a mere seven days after the filing of the application, and fewer still would be prepared to file comments on the proper scope of the environmental review within another thirty-eight days.

In the Conrail transaction the STB undertook strenuous efforts to make communities aware of the issues involved. Nonetheless, in its own outreach efforts, DOT found that many communities were unaware of the potential impacts until late in the process, especially in cases where expected impacts changed as a result of agreements between the applicants and other communities. If the Board and applicants can craft a satisfactory agreement that assures meaningful notice to communities and ample time for their responses, this objection to a shortened schedule could be removed.

E. Transnational Issues

Most commenters supported the Board's proposals to address major transactions that involve a non-U.S. railroad. See, e.g., Comments of the Department of Defense; Norfolk Southern Railway Co.; Union Pacific Railroad Co. ("UP"); Weyerhauser Company. Contra, Comments of the Wisconsin Central System. They agree, for example, that only with the submission of information about the "full system" of the resulting carrier can the STB determine the true impact on the public interest. See Comments of Canadian Pulp and Paper Association.

Other parties believe that the proposed rules either go too far or do not go far enough. Some ask the Board to do more, e.g., equalize rates and services on both sides of our borders, extend U.S. law (federal and state) to foreign-based carriers, or require equal treatment of ports. See Comments of National Grain and Feed Association; North Dakota Public Service Commission; California Public Utilities Commission; Port of Seattle; Port Authority of New York and New Jersey; Greater Houston Partnership. Others insist that the STB must do less, on the grounds that seeking particular information only when a Canadian or Mexican railroad is involved is discriminatory treatment in violation of the North American Free Trade Agreement ("NAFTA"). See Comments of the Canadian Pacific Railway Co. ("CP") and Canadian National Railway Co. ("CN").

The Department continues to endorse the Board's proposals. They serve the fundamental purpose of informing the STB about facts, laws, and policies that are important to an accurate and comprehensive understanding of major transactions. In that respect they do what applicable regulations have always done. In a combination involving only U.S. carriers, of course, the existence and application of relevant facts, law, and policy are either familiar or easily explored. That is not the case with transactions involving foreign-based railroads. Thus, without modification to its rules, the Board is in jeopardy of not knowing circumstances that can affect the public interest simply because they originate beyond our borders.

To suggest that compiling a record in these cases is discriminatory or in violation of NAFTA is simply wrong. To the contrary, securing data, subjecting it to scrutiny, and consulting with appropriate governmental authorities will serve to inform the STB's decisionmaking, and thereby its consistency with NAFTA.

By the same token, the Board should resist efforts to adopt standards addressing international rail rates, equipment policies, or port service at the outset. There is no information as yet on the factual specifics of any of these issues, and neither is there any record on the legalities or policy implications of prospective approval criteria or conditions that would have extra-territorial application. DOT submits that the only proper course at this time is to adopt regulations that will assure that needed information is gathered. In individual cases the Board should be guided by the established U.S. policy of seeking to assure that U.S. commercial interests have an equal opportunity to compete with their foreign counterparts. A "level playing field" that is not tipped one way or another by non-economic considerations should be the overarching goal in this regard.

The Department also previously urged the STB to be sensitive to the considerations that the Department of Defense ("DOD") brings to bear in this proceeding. DOT Initial Comments at 23-24. DOD supports the proposed rules "in their entirety" as a general matter, and has suggested specific issues of concern that the record in future merger cases should address. DOD Comments, passim. We repeat our request that the Board pay special heed to DOD's views.

F. Scope of the New Standards

A few commenters have recommended that the STB impose its final rules not on every transaction involving two Class I railroads, but only on those truly large combinations whose transcontinental reach has given rise to the need for heightened scrutiny. See Comments of the Kansas City Southern Railway Co. and Wisconsin Central System. DOT agrees that not every existing or prospective Class I carrier is of equal size and scope, and therefore not every potential "major" consolidation will pose the quantum of risk presented in a transcontinental merger. We suggest that parties in such cases may continue to seek clarification and/or waivers of otherwise applicable provisions. 49 C.F.R. § 1180.3(d), (e).

G. "End Game" Considerations

DOT remains concerned about potential "downstream" impacts of mergers among the remaining major Class I carriers. DOT Initial Comments at 20. Although we have consistently urged the Board to consider the consequences of potential transactions, we have also urged caution in deciding cases or adopting conditions based on applicants' predictions about future events, and we suggested that the Board provide greater specificity to guide potential applicants and others. Id. at 21.

These concerns arise from the so-called "end game," in which a transcontinental rail duopoly is the result of a final round of consolidation. The Department has supported requiring applicants to address this issue, even in cases where the actual transaction being considered would not result in a transcontinental merger but would appear to encourage "defensive" mergers that might lead to transcontinental mergers.

Several parties argued that requiring applicants to address these issues would be "unduly burdensome" (CP Comments at 16), or "misguided," requiring "predictions that no one can reliably make." UP Comments at 4. Similarly, another maintained that it "cannot be done in a principled fashion and would unnecessarily expand regulation in a substantial departure from the basic deregulatory tenets of the Act." CN Comments at 16. The general feeling of these commenters is that the Board's "proper response to the likelihood of future mergers and a possible transcontinental duopoly is careful scrutiny of actual transactions, not abstract and hypothetical speculation." Id.

In its comments, UP again supported thorough consideration of downstream effects in future merger transactions. "As the Board has found, the next major merger is likely to lead to creation of two transcontinental railroads. Before approving another major rail merger, the Board should determine whether this final round of railroad consolidations is desirable. Presumptively,

this will be the central public policy issue in a future Class I merger proceeding." UP Comments at 3-4 (citation omitted).

Although the UP argument is logical, DOT suggests that the time to consider the question of a rail duopoly is not when the transaction that would create it is presented, but in advance. As Secretary Slater stated at the Board's March 7 hearing, "we cannot afford to ultimately find ourselves with two ... railroads that are too big to manage and too big to be allowed to fail." Statement at 10. We agree that the Board could open a proceeding now on issues that might be involved in transcontinental mergers or those resulting in a rail duopoly, to surface and address the issues that drive concerns about such mergers. While the filings in such a proceeding may be largely theoretical, they could provide information to allow the Board to specify what would be required of duopoly applicants, thereby providing advance guidance and avoiding the cost and disruption of a rejected merger. Alternatively, if the proceeding demonstrated that such a merger would not be in the public interest, the Board could turn to Congress for authority to reject out-of-hand any "duopoly" merger, if it does not feel it has such authority itself. In any event, the proceeding would educate and prepare us for the future.

We note that several large regions of the country already have duopoly rail service. Any new proceeding could examine duopoly issues based on current performance in those areas. Important issues to be examined could include willingness to innovate, service, safety and rates. Public benefits from the last round of mergers could be examined as well. This proceeding could be used as well to identify the proper issues of concern and address the efficacy of possible mitigation measures.

III. CONCLUSION

The Board has made significant progress in developing standards to apply to future consolidations among Class I railroads. Further clarification is still required in some important areas, such as competition-related criteria, while other matters merit continued exploration, such as expedited procedures or different treatment for smaller rail transactions. The Department looks forward to further refinement of the record in the next, final round of public comments.

Respectfully submitted,

ROSALIND A. KNAPP
Acting General Counsel

December 18, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have on this day caused to be served on all Parties of Record by first-class mail, postage prepaid, a copy of the foregoing Reply Comments of the United States Department of Transportation filed in Ex Parte No. 582 (Sub-No. 1).

Paul Samuel Smith

December 18, 2000